(2) Supreme Court, U.S.
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No. ——

# In the Supreme Court of the United States

PAUL HUDSON, *ET AL.*,
*Petitioners*,

v.

AEP TEXAS NORTH COMPANY, *ET AL.*,
*Respondents*.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

## APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit
FILED
December 21, 2006
Charles R. Fulbruge III
Clerk

**No. 05-51755**

AEP TEXAS NORTH CO.,

Plaintiff-Appellee,

versus

TEXAS INDUSTRIAL ENERGY CONSUMERS,

Intervenor-Defendant,

versus

CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS,

Intervenor-Defendants
-Appellants,

versus

THE PUBLIC UTILITY COMMISSION OF TEXAS, ET AL.,

Defendants,

PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS; JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS; and BARRY T. SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS,

Defendants-Appellants.

Appeals from the United States District Court
for the Western District of Texas
(USDC No. 1:04-CV-1069)

Before REAVLEY, STEWART and CLEMENT, Circuit Judges. REAVLEY, Circuit Judge:

The issue before us is whether a state regulatory agency may set retail rates based on its own determination that a utility has not complied with a Federal Energy Regulatory Commission ("FERC") tariff. We hold that pursuant to the filed rate doctrine, federal law preempts state regulators from making a final determination as to whether a FERC tariff has been violated and from imposing a remedy for an alleged violation. We therefore affirm.

## I.

### A. The Merger

Appellee Texas North Company ("TNC") provides retail electric service solely in Texas. In 1999, TNC's parent, the Central and South West Company, merged with the American Electric Power Company ("AEP"). TNC is now one of nine public utilities owned by AEP.

Before the merger, AEP submitted a merger plan, termed the System Integration Agreement (the "SIA"), for approval to FERC. FERC approved the plan. The SIA is the tariff, or rate schedule, currently filed with FERC.

When the AEP system has an excess of generating capacity, an affiliate of the utilities, called the AEP Service Corporation ("AEPSC") sells the excess power at wholesale. The SIA requires that AEPSC determine the profits from such sales, called Trading and Marketing Realizations ("TMRs"), "on an hourly basis." The SIA defines TMRs as "the difference between i) the revenues collected from Trading and Marketing Activities and ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities."

The SIA then mandates that from sales made by all, AEPSC will distribute the TMRs between two zones in the AEP system,

according to a specific formula. The distribution occurs in two stages. First, the SIA provides that all TMRs up to a certain amount (equaling the amount of TMRs that were recorded in a Base Year, the twelve month period preceding the merger) will be allocated between the former Central and South West company (now called AEP West) and the former AEP company (now called AEP East) as they were in the Base Year. This first allocation favors AEP East. Second, all remaining TMRs are allocated between AEP East and AEP West in proportion to generating capacity. This allocation favors AEP West. Therefore, TNC is favored in the second stage of the allocation process.

B. The Commission's Review

Immediately before Texas moved to a deregulated electricity market in 2002, the Texas Legislature mandated that the successors of the former public utilities seek a final reconciliation of their regulated fuel expenses and revenues before the Public Utility Commission of Texas (the "Commissioners"). According to Texas law, after costs and revenues are reconciled, the utilities must refund any over-recovery to the utility's retail ratepayers. 16 Tex. Admin. Code Ann. § 25.236(e) (2002). TNC filed a petition for a final reconciliation in June 2002.

In the first proceeding related to this appeal, the Commissioners found that the TMR allocations were correctly calculated pursuant to the SIA. On rehearing, however, the Commissioners disagreed with AEPSC's calculation of TMRs in the Base Year. AEPSC credited the AEP East companies with the values of "open" transactions that had not yet been completed, as well as the profits from completed sales. The Commissioners determined that including the "open" transactions (a method of accounting known as

"mark-to-market") in the Base Year calculations was not consistent with the SIA, which defined TMRs as the difference between revenues collected and out-of-pocket costs.

The Commissioners then proceeded to rectify the alleged error in calculations. The parties in the reconciliation proceeding stipulated that the mark-to-market accounting resulted in $7.9 million less in revenues for TNC. The Commissioners ordered that TNC reduce its retail rates as if it had received this revenue. However, AEPSC did not change its method of calculating TMRs. Because of the lower retail rates, TNC was forced to absorb the difference between the actual allocation of revenues and the lower retail rates. TNC filed a motion for rehearing, which was overruled.

TNC filed this action in federal court, challenging the order on preemption grounds. The district court granted TNC's motion for summary judgment, finding that the Commissioners' ruling violated the Federal Power Act and the Supremacy Clause of the U.S. Constitution.

II.

A.

The Federal Power Act ("FPA") gives FERC exclusive jurisdiction to regulate the transmission and wholesale sale of electric energy in interstate commerce.[1] The filed rate doctrine, which governs this case, derives from that jurisdictional grant. "The filed rate doctrine requires 'that interstate power rates filed with FERC or fixed by FERC must be given binding effect

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1. 16 U.S.C. § 824(b)(1).

by state utility commissions determining intrastate rates.' "[2] The FPA and the Supremacy Clause, U.S. Const. art. VI, § 2, preempt any state action modifying or overruling a filed rate.[3] Pursuant to the doctrine, the Supreme Court has determined that federal law preempts states from second-guessing FERC's allocations of electric power[4] and from conducting prudence inquiries into FERC's cost allocations, even when FERC has not conducted such an inquiry.[5] In addition, states are prohibited from "trapping costs" by setting retail sales at a level that would prevent a utility "from recovering the costs of paying the FERC-approved rate."[6]

In *Entergy*, the most recent Supreme Court case dealing with the filed rate doctrine, the Court considered "whether a FERC tariff that delegates discretion to the regulated entity to determine [a] precise cost allocation ... preempts a [state commission's] order that adjudges those costs imprudent."[7] The Entergy Corporation owned five different public utilities, which could use each other's excess capacity. The costs of keeping

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2. *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39, 47, 123 S.Ct. 2050, 2056 (2003) ("*Entergy*") (quoting *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962, 106 S.Ct. 2349, 2354 (1986)).

3. *Entergy*, 539 U.S. at 47, 123 S.Ct. at 2056.

4. *Nantahala*, 476 U.S. at 955, 106 S.Ct. at 2351.

5. *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 357, 108 S.Ct. 2428, 2431 (1988).

6. *Nantahala*, 476 U.S. at 970, 106 S.Ct. at 2358-59.

7. *Entergy*, 539 U.S. at 42, 123 S.Ct. at 2053.

excess capacity available were shared among the utilities according to a provision in a system agreement, filed with FERC, that Entergy's operating committee administered. The provision at issue was an automatic adjustment clause, which under § 205(f) of the FPA allows for increases or decreases in a utility's paid costs without prior hearings.[8] In determining costs, the operating committee designated certain generating units (called Extended Reserve Shutdown, or ERS, units) as "available" when those units were actually shut down, but could be activated in emergencies.[9] This designation caused Entergy Louisiana, Inc., a utility with ERS units, to pay a higher percentage of costs. The Louisiana Public Service Commission found that although it was preempted from determining whether the system agreement was violated, it could determine that Entergy's expenditures were imprudent because Entergy paid more for possessing ERS units.[10] Thus, the Louisiana Commission did not allow Entergy to increase retail rates to cover those costs.[11]

The Supreme Court reversed, holding that the Commission's prudence inquiry was preempted even though the proper classification of ERS units was not pursuant to a specific mandate from FERC, but instead was within the discretion of

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8. *Id.* at 42-43, 123 S.Ct. at 2053-54.

9. *Id.* at 43, 123 S.Ct. at 2054.

10. The Louisiana Public Service Commission looked only at the time period after August 5, 1997, as FERC had already found that categorizing the ERS units as "available" was reasonable prior to August 5, 1997. *Id.* at 44, 123 S.Ct. at 2054.

11. *Id.* at 45, 123 S.Ct. at 2055.

the operating committee.[12] The Court found that the Commission's order impermissibly "trapped costs" by failing to allow Entergy to recoup the costs of paying for the ERS units.[13]

B.

Here, we also consider a tariff which designates an agent to perform an allocation (although *Entergy* involved an allocation of costs, rather than revenues). Appellants argue that the instant case can be distinguished from *Entergy* because in this case, AEPSC's interpretation of the formula violated the language of the filed tariff, an issue which was not before the Court in *Entergy*.[14] They contend that the Commissioners' order correctly interpreted the tariff, and therefore fulfilled the state's obligation to implement the filed rate.

Although Appellants argue the Commissioners' order implemented the filed rate, the entire SIA, not simply the formula in question, is filed with FERC. "[T]he filed rate doctrine is not limited to 'rates' *per se*."[15] The states are bound to implement a FERC-approved agreement, and the agreement

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12. *Id.* at 49-50, 123 S.Ct. at 2057 ("We see no reason to create an exception to the filed rate doctrine for tariffs of this type that would substantially limit FERC's flexibility in approving cost allocation arrangements.").

13. *Entergy*, 539 U.S. at 49, 123 S.Ct. at 2056.

14. *Id.* at 50-51, 123 S.Ct. at 2058.

15. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S.Ct. 2349, 2357 (1986). *See also Entergy*, 539 U.S. at 50, 123 S.Ct. at 2056 ("It matters . . . only whether the FERC tariff dictates how and by whom [the] classification should be made.").

authorizes only AEPSC to implement the formula.[16]

Furthermore, FERC not the state, is the appropriate arbiter of any disputes involving a tariff's interpretation.[17] Congress has given FERC exclusive jurisdiction to determine whether wholesale rates are just and reasonable.[18] Additionally, it is FERC's duty under the FPA to make an assessment of the broad public interests involved in determining interstate rates.[19] If each state could enforce its own findings as to the meaning of a filed tariff, in opposition to the conclusions of a FERC-approved agent, the conflicting interpretations would undermine FERC's ability to ensure that a filed rate is uniform across different states, and intrude upon its exclusive

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16. *See Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 374, 108 S.Ct. 2428, 2440 (1988) ("States may not regulate in areas where FERC has properly exercised its jurisdiction . . . to insure that agreements affecting wholesale rates are reasonable.").

17. *See id.* at 2442-43 (1988) (Scalia, J., concurring) ("[W]hether one characterizes the questions as related to prudence, interpretation [of the basic system agreements], or cost allocation, they are clearly matters most appropriately resolved by the Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.") (quoting *AEP Generating Co.*, 36 FERC ¶ 61,226 (1986)).

18. 16 U.S.C. §§ 824d, 824e. *See also Mississippi Power*, 487 U.S. at 377, 108 S.Ct. at 2442 (Scalia, J., concurring) ("It is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject.").

19. *See* 16 U.S.C. § 824(a).

jurisdiction over interstate power transactions.[20] Therefore, it is within FERC's jurisdiction, not the states', to make a final determination as to whether the tariff has been violated. If a state disputes a utility's interpretation of a tariff, FERC is the proper forum for resolving the disagreement.[21]

Finally, the FPA gives FERC exclusive jurisdiction to remedy tariff violations by providing refunds.[22] If states could remedy perceived violations by setting retail rates based on their own calculations, states could potentially "trap" costs by prohibiting the utility from passing on the price of FERC-mandated rates to consumers.[23] Thus, the filed rate doctrine requires that the states use AEPSC's calculations to set retail rates until FERC resolves any dispute over the tariff's interpretation.

III.

We find that the Commission's actions were preempted by the Supremacy Clause and the Federal Power Act.

AFFIRMED.

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20. *See Appalachian Power Co. v. Public Service Comm'n of West Virginia,* 812 F.2d 898, 905 (4th Cir.1987).

21. *Cf. Mississippi Power,* 487 U.S. at 375, 108 S.Ct. at 2441 (finding that the "only appropriate forum" for determining the reasonableness of filed rates and agreements "is before the Commission or a court reviewing the Commission's order.").

22. *See* 16 U.S.C. § 824e.

23. *See Mississippi Power,* 487 U.S. at 372, 108 S.Ct. at 2439. Appellants claim that in this case, no costs were "trapped" because the formula at issue involved the allocation of revenue, not costs. Nonetheless, the result was the same: the utility lost money.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

| | | |
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| AEP TEXAS NORTH COMPANY, | § | CAUSE No. |
| PLAINTIFF, | § | |
| | § | |
| V. | § | A-04-CA-1069-LY |
| | § | |
| PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS, JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, AND BARRY SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, | § | |
| DEFENDANTS. | § | |

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**MEMORANDUM OPINION AND ORDER**

Before the Court are Plaintiff AEP Texas North Company's Motion for Summary Judgment and Memorandum of Law in Support filed February 23, 2005 (Doc. ## 11, 12); Plaintiff's Statement of Material Facts filed February 23, 2005 (Doc. # 13); Commissioners' Response to Plaintiff's Statement of Material Facts filed April 1, 2005 (Doc. # 25); Commissioners' Response and Cross-Motion for Summary Judgment filed April 1, 2005 (Doc. ## 26, 27); Intervenor Cities' Response to Plaintiff's Motion for Summary Judgment filed April 1, 2005 (Doc. # 29); Plaintiff's Reply in Support of Summary Judgment

and Opposition to Cross-Motion for Summary Judgment filed April 12, 2005 (Doc. ## 32, 33); Commissioners' Supplemental Brief in Support of Judgment filed May 27, 2005 (Doc. # 41); Intervenor Cities' letter brief filed May 27, 2005 (Doc. # 42); and Plaintiff's Response to Defendants' Supplemental Brief filed June 7, 2005 (Doc. # 43). On June 21, 2005, this Court held a hearing on the above-listed motions. Plaintiff AEP Texas North Company ("AEP Texas") appeared by counsel; Defendants the individual Commissioners (hereinafter referred to collectively as the "Commissioners") appeared by counsel; and Intervenors the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon, Texas appeared by counsel. Having carefully considered the motions, responses, replies, along with the summary-judgment evidence in the Texas Public Utility Commission ("PUC") record and the case law applicable to this action, this Court concludes that summary judgment should be granted in favor of AEP Texas, and that the Commissioners' cross-motion for summary judgment should be denied for the reasons set forth below.

## I. Background

AEP Texas is a wholly owned subsidiary of American Electric Power Company ("AEPC"), a multistate electric-utility holding company. AEPC's subsidiary companies provide electrical service to approximately five million customers in parts of eleven states. This cause involves a System Integration Agreement ("SIA") among nine of AEPC's operating companies that provides for an agent-the American Electric Power Service Corporation ("AEPSC")-to allocate "Trading and Marketing Realizations" that the AEPC system earns from a category of wholesale-electricity market transactions. The SIA is a wholesale rate schedule on file with the Federal Energy Regulatory Commission ("FERC").

AEP Texas is a party to the SIA. The SIA provides the contractual basis for the distribution of certain power supply costs and benefits between two zones of AEPC, the east zone and the west zone, corresponding to the premerger systems of AEPC and Central and South West Corporation ("CSW"), two public utility holding companies.[1] As a wholly owned subsidiary of AEPC, AEP Texas is also required to share revenues with its retail customers under the SIA.

On June 3, 2002, AEP Texas applied to the PUC to reconcile its fuel expenses and revenues for the period of July 1, 2000, through December 31, 2001. One issue before the PUC involved the amount of revenue that AEP Texas was required to share with its customers under the terms of the SIA and the Integrated Stipulation and Agreement approved by the Commissioners following the merger of AEPC and CSW. The service schedule at issue is Service Schedule D, which allocates the Trading and Market Realizations ("TMRs") on the system. The SIA provides that the TMRs, or profits, from off-system sales and purchases of power, energy, or capacity are to be allocated between the AEP east and west zones. Section 1.39 of the SIA defines TMRs as "the difference between (i) revenues collected from Trading and Marketing activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing activities and any transmission cost related to such activities."

The SIA designates AEPSC to centrally calculate the TMRs. The SIA also sets forth a process for making such allocations. In the first stage, realizations are allocated such that the AEPC east and west zones receive the same amount of realizations as they did in the "Base Year" (July 1999 through

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1. The merged entity took the name "American Electric Power Company."

June 2000). In the second stage, all profits above the amount earned during the Base Year are divided between the AEPC east and west zones according to their relative ownership of generating capacity. Once the TMRs have been allocated between the AEPC east and west zones, and AEP Texas receives its portion, the SIA specifies how AEP Texas is to share its revenue with its retail customers.

As part of its review of AEP Texas's application to reconcile fuel expenses and revenues, the Commissioners examined AEPSC's allocation of TMRs under the terms of the SIA. In calculating the realizations for the Base Year, AEPSC used "mark to market" accounting in which the "open" transactions, or transactions that had yet to be completed, were recorded at market value, while "closed" or completed transactions were recorded at the actual contract value. Both open and closed transactions were included in the level of realizations achieved in the Base Year. Thus, AEPSC's proposed Base Year allocation of TMRs included both open and closed transactions.

The Commissioners disagreed with AEPSC's allocation under the SIA, determining that AEPSC improperly included TMRs resulting from open transactions in the Base Year allocation. The Commissioners required AEP Texas to recalculate the TMR allocation to exclude all open transactions, resulting in a higher share of TMRs for the AEPC west zone and a correspondingly higher amount of revenue to be shared with AEP Texas's customers.

AEP Texas filed a motion for rehearing on the grounds that the Commissioners' decision violated the Federal Power Act[2]

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2. 16 U.S.C. §§ 791a-828c (2000 & Supp. 2005).

and the Supremacy Clause of the United States Constitution,[3] specifically arguing that the Commissioners were federally preempted from reviewing AEPSC's allocation of TMRs and that they were required to accept that allocation methodology until and unless FERC ruled otherwise. The motion was overruled by operation of law, and the Commissioners' order became final and appealable on December 5, 2004. *See* TEX. GOV'T CODE ANN. § 2001.146(c) (West 2000 & Supp. 2005).

On December 21, 2004, AEP Texas filed suit in this Court challenging the Commissioners' final order in PUC Docket 26000[4] to the extent that the Commissioners required AEP Texas to reallocate the TMRs. On December 22, 2004, AEP Texas also filed a petition for judicial review in state district court in Travis County, Texas, challenging other aspects of the Commissioners' decision but reserving the contentions raised in this appeal. *See TNC v. Public Util. Comm'n,* Docket No. GN4-04175, 98th Dist. Ct., Travis County, Texas (filed Dec. 22, 2004).

## II. Analysis

***Summary-Judgment Standard***

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, summary judgment is proper where there is no genuine dispute of a material fact that a party is entitled to judgment as a matter of law. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248; *Williams v. Adams,* 836 F.2d 958, 960 (5th Cir.1988). "If the moving party meets the initial burden of showing there is no

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3. U.S. CONST. art. VI, § 2.

4. *Application of West Texas Utilities for Authority to Reconcile Fuel Costs,* PUC Docket No. 26000, Order on Rehearing (Oct. 18, 2004).

genuine issue of material fact, the burden shifts to the nonmoving party to produce evidence or designate specific facts showing the existence of a genuine issue for trial." *Allen v. Rapides Parish Sch. Bd.*, 204 F.3d 619, 621 (5th Cir. 2000) (internal quotations and citations omitted). When both parties move for summary judgment, the court reviews each party's motion independently, viewing the evidence and inferences in the light most favorable to the nonmoving party. *Ford Motor Co. v. Texas Dept. of Transp.*, 264 F.3d 493, 498 (5th Cir. 2001) (citing *Taylor v. Gregg*, 36 F.3d 453, 455 (5th Cir. 1994)). Doubts are to be resolved in favor of the nonmoving party, and any reasonable inferences are to be drawn in favor of that party. *See Burch v. City of Nacogdoches*, 174 F.3d 615, 619 (5th Cir. 1999). However, "[n]either 'conclusory allegations' nor 'unsubstantiated assertions' will satisfy the non-movant's burden," *Wallace v. Texas Tech Univ.*, 80 F.3d 1042, 1047 (5th Cir. 1996), and only disputes over facts that might affect the outcome of the lawsuit under governing law will preclude the entry of summary judgment, *see Anderson*, 477 U.S. at 247-48.

Summary judgment is designed to "secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett*, 477 U.S. 317, 327. A claim for declaratory judgment is appropriate for summary judgment when it presents questions of law for the court. *Millennium Petrochemicals, Inc. v. Brown & Root Holdings, Inc.*, 390 F.3d 336, 339 (5th Cir. 2004). Matters regarding federal preemption are questions of law for the court. *E.g., Texas Manufactured Housing Ass'n. Inc. v. City of La Porte*, 974 F.Supp. 602, 604, 607 (S.D. Tex. 1996). Accordingly, whether the Commissioners' actions are constitutionally valid is a question of law that this Court may decide on summary judgment.

***Federal Preemption under Federal Power Act and Supremacy Clause***

AEP Texas asserts that the Commissioners' assumption of jurisdiction is foreclosed by *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39 (2003). AEP Texas argues that *Entergy Louisiana* held that state regulatory authorities may not second guess the allocation of costs and revenues among operating companies in a multistate power system even where, as here, the federal tariff has "delegate[d] discretion to the regulated entity to determine the precise . . . allocation." *Id.* at 42. Because Congress has given FERC exclusive jurisdiction to interpret and enforce the terms of the federal tariff, AEP Texas argues, FERC alone may determine the reasonableness of the regulated utility's allocation of costs or revenues under a FERC tariff, and the Commissioners must accept the costs and revenues set under such tariffs and pass them through to retail customers unless and until FERC determines otherwise.

In their response and cross-motion for summary judgment, the Commissioners assert that their decision to reject AEPSC's allocation of TMRs was entirely proper because they properly read and applied the terms of the SIA and, following the plain language of the SIA, their decision violates neither the Federal Power Act nor the Supremacy Clause.[5]

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5. The Intervenors' response to AEP Texas's motion for summary judgment argues that federal preemption and the filed-rate doctrines do not apply to the Commissioners' actions in this cause because the Commissioners are only applying the federal tariff under the terms of the SIA. This argument is subsumed in that of the Commissioners, and therefore this Court will address both arguments together.

The dispute in this cause centers on the Commissioners' decision to exclude the value of the open transaction from AEPSC's allocation of TMRs under the SIA. Section 1.39 of the SIA defines TMRs as the difference between "revenues collected" and out-of-pocket costs plus transmission expenses and section 1.9 of the SIA defines "Base Year" allocation as the relative percentage of total margins "received" by the AEP operating companies, on the one hand, and the CSW operating companies, on the other. The Commissioners argue that because AEPC neither collected revenue, nor received a realization during the Base Year from open transactions, the plain language of section 1.9 and 1.39 of the SIA required AEPSC to exclude such transactions from the Base Year allocation.

The parties agree that FERC has exclusive jurisdiction to regulate interstate wholesale-power rates and that the "filed rate doctrine" requires the Commissioners to follow the terms of the SIA when setting AEP Texas's retail rates. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965-6 (1986). The Commissioners argue, however that the SIA provides no discretion for AEPSC to alter the definition of TMRs under section 1.39 of the SIA. AEP Texas argues that the SIA says nothing about AEPSC's use of a particular accounting methodology, and therefore the Commissioners may not review AEPSC's allocation of TMRs.

The Federal Power Act grants FERC exclusive jurisdiction to regulate the transmission and sale of electric energy at wholesale in interstate commerce. 16 U.S.C. § 824. The act provides that all rates and charges, and all rules and regulations affecting such charges, must be "just and reasonable," *id.* at § 824d(a), and nondiscriminatory, *id.* at § 824d(b). To enable FERC to enforce this prohibition, section 205(c) of the Federal Power Act requires public utilities to file with FERC

"schedules" or "tariffs" that show that their rates and charges for wholesale sales of electricity and the classifications, practices, and regulations affecting such charges, together with all contract which in any manner affect or relate to such charges. *Id.* at § 824d(c). The SIA is a federally approved tariff on file with FERC as a rate schedule. Schedule D3 of the SIA provides the methodology for AEPSC's allocation of TMRs.

The United States Supreme Court has consistently construed the Federal Power Act to grant FERC jurisdiction to make all determinations required to regulate wholesale rates and to allocate costs among affiliated utilities, regardless of the impact on state regulation. *See FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-52 (1951). Any state action is therefore preempted if its effect is to interfere with FERC's interstate allocation of costs among the companies of an integrated power system. *See Maryland v. Louisiana*, 451 U.S. 725, 749-50 (1981).

The Supreme Court developed the "filed-rate doctrine" to "enforce the exclusive jurisdiction vested by Congress in FERC" and thereby give effect to the Supremacy Clause. *Nantahala Power & Light Co.*, 476 U.S. at 966, 969. Under this doctrine, interstate power rates that are filed with FERC or fixed by FERC must be treated as lawful in a state or federal proceeding unless and until they are changed by FERC, *id.* at 970, and no tribunal may enter an order that would have the effect of "authoriz[ing] commerce in the commodity on other terms." *Montana-Dakota Utils. Co.*, 341 U.S. at 251.

In *Entergy Louisiana*, the Supreme Court held that state law was preempted under the filed-rate doctrine notwithstanding the nonspecific nature of the FERC tariff in question, which "delegate[d] discretion to the regulated entity to determine the

precise cost allocation" between affiliated companies that was being challenged. 539 U.S. at 42. The Court then rejected the argument that the filed-rate doctrine is limited to tariffs providing specific mandates, holding that "[i]t matters not whether FERC has spoken to the precise classification ..., but only whether the FERC tariff dictates how and by whom that classification should be made." *Id.* at 49-50.

The overriding principle from *Entergy Louisiana* is that FERC has exclusive jurisdiction over transactions among affiliated utilities operating an interstate power pool and over all the complex interrelated questions that these arrangements present. "[W]hether one characterizes the questions as related to prudence, interpretation [of the basic service agreements], or cost allocation, they are clearly matters most appropriately resolved by [FERC] as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules." *Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 378 (1988) (Scalia, J., concurring in the judgment)(quoting *AEP Generating Co.*, 36 FERC ¶ 61,226, at 61,550 (1986)).

Applying these principles, the Court finds that the Commissioners improperly assumed jurisdiction to review and reject AEPSC's allocation of TMRs. Schedule D of the SIA is a tariff fixed by and filed with FERC that sets forth how and by whom the allocation of the revenues from selling power among members of an integrated interstate power pool are decided. FERC found that the SIA was "just and reasonable" under Section 205 of the Federal Power Act and approved it. *American Elec. Power Co. & Cent. & SW. Corp.*, 90 FERC ¶ 61,242, at 61,797 (2000). Thus, the omission of AEPSC's use of a particular accounting methodology must be interpreted to grant deference to AEPSC to choose the accounting methodology it will use to allocate the TMRs. It clearly may not

be interpreted to grant the Commissioners the authority to assign their preferred accounting methodology on AEPSC.[6] Therefore, the Commissioners must accept AEPSC's allocation of TMRs under Schedule D3 unless and until FERC says otherwise.[7]

Congress has provided states with the ability to seek a remedy at FERC for any action inconsistent with the federal tariff. Under section 825e of Title 16 of the United States Code, a state may file a complaint with FERC about inter-utility activities and these complaints may ultimately result in FERC action declaring rates, practices, and contracts unjust and unreasonable and establishing new ones. 16 U.S.C. §§ 824e(a), 824d(e), 825e. Thus the Commissioners, dissatisfied with AEPSC's allocation of TMRs under the SIA, may seek a determination from FERC that the SIA has been violated.[8]

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6. The Court also notes that although the PUC has jurisdiction over AEP Texas because AEP Texas provides retail electric services in Texas, the PUC has no jurisdiction over AEPSC that makes the calculations under SIA, which would logically be a precondition to adjudicating claims that its calculations violated that federal tariff.

7. Schedule D3 of the SIA also provides that any new methodology for allocating TMRs, beyond the period of time specified under the terms of the SIA, must be filed with FERC for approval, expressly granting jurisdiction to review AEPSC's allocation methodology with FERC.

8. Having determined that the Commissioners are preempted from reviewing AEPSC's allocation of TMRs under the terms of the SIA, this Court need not address AEP Texas's Commerce Clause argument. U.S. CONST. art. I, § 8, cl. 3.

## III. Conclusion

This Court therefore concludes that the Commissioners' actions, in violation of the Federal Power Act and the Supremacy Clause, usurped a function that Congress has assigned to FERC. *See Nantahala Power & Light Co.*, 476 U.S. at 964. The sole remedy for any alleged violation of the SIA is at FERC. The Commissioners therefore were preempted from deciding that issue. In accordance with the foregoing:

**IT IS ORDERED** that Plaintiff AEP Texas North Company's Motion for Summary Judgment filed February 23, 2005 (Doc. # 11) is **GRANTED**.

**IT IS FURTHER ORDERED** that the Commissioners' Cross-Motion for Summary Judgment filed April 1, 2005 (Doc. # 27) is **DENIED**.

**IT IS FINALLY ORDERED** and **DECLARED** that Defendants Commissioners Paul Hudson, Julie Parsley, and Barry Smitherman are preempted by federal law under the Federal Power Act and the Supremacy Clause of the U.S. Constitution, and Defendants are **ENJOINED** from enforcing their ruling regarding the allocation of trading and marketing realizations in the following matter: *Application of West Texas Utilities for Authority to Reconcile Fuel Costs,* PUC Docket No. 26000.

SIGNED this 19th September, 2005.

LEE YEAKEL
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

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| AEP TEXAS NORTH COMPANY, PLAINTIFF, | § | CAUSE No. |
| V. | § | A-04-CA-1069-LY |
| PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS, JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, AND BARRY SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, DEFENDANTS. | § | |

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**FINAL JUDGMENT**

Before the Court is the above-entitled cause. On this same date, this Court signed a Memorandum Opinion and Order on cross-motions for summary judgment denying Defendants' Cross-Motion for Summary Judgment, granting Plaintiff's Motion for Summary Judgment, and ordering and declaring that Defendants' ruling was preempted by federal law. Accordingly, the Court enters the following Final Judgment pursuant to Federal Rule of Civil Procedure 58.

**IT IS HEREBY ORDERED AND DECLARED** that Defendants Commissioners Paul Hudson, Julie Parsely, and Barry Smitherman are preempted by federal law under the Federal Power Act and the Supremacy Clause of the U.S. Constitution, and Defendants are ENJOINED from enforcing their ruling regarding the allocation of trading and marketing realizations in the following matter: *Application of West Texas Utilities for Authority to Reconcile Fuel Costs*, PUC Docket No. 26000.

**IT IS FURTHER ORDERED** that all relief not expressly granted is hereby DENIED.

**IT IS FINALLY ORDERED** that the case hereby **CLOSED**.

SIGNED this 26th day of September, 2005.

LEE YEAKEL
UNITED STATES DISTRICT JUDGE

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE FIFTH CIRCUIT**

**No. 05-51755**

U.S. COURT OF APPEALS
FILED
JAN 26 2007
CHARLES R. FULBRUGE III
CLERK

AEP TEXAS NORTH COMPANY
Plaintiff-Appellee

v.

TEXAS INDUSTRIAL ENERGY CONSUMERS
Intervenor-Defendant

v.

CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS
Intervenor-Defendant-Appellant

v.

THE PUBLIC UTILITY COMMISSION OF TEXAS, ET AL.
Defendants

PAUL HUDSON, Chairman of the Public Utility Commission of Texas; JULIE PARSLEY, Commissioner of the Public Utility Commission of Texas; BARRY T. SMITHERMAN, Commissioner of the Public Utility Commission of Texas
Defendants-Appellants

Appeal from the United States District Court for the Western District of Texas, Austin

ON PETITION FOR REHEARING AND REHEARING EN BANC

(Opinion 12/21/06, 5 Cir., _____, _____ F.3d _____)

Before REAVLEY, STEWART and CLEMENT, Circuit Judges.

PER CURIAM:

(✓) The Petitions for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petitions for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

United States Circuit Judge

REHG-4A

**PUC DOCKET NO. 26000**
**SOAH DOCKET NO. 473-02-3169**

| | | |
|---|---|---|
| **APPLICATION OF WEST TEXAS UTILITIES FOR AUTHORITY TO RECONCILE FUEL COSTS** | **§** | **PUBLIC UTILITY COMMISSION OF TEXAS** |

## ORDER ON REHEARING

This Order addresses West Texas Utilities Company's (WTU's)[1] application for reconciliation of its fuel expenses and revenues for the period from July 1, 2000 through December 31, 2001. This is the final fuel reconciliation for WTU. Except as provided in this Order on Rehearing, the Public Utility Commission of Texas adopts the proposal for decision (PFD) and supplemental PFD, including findings of fact and conclusions of law, issued by the administrative law judges (ALJs) for the State Office of Administrative Hearings (SOAH) on March 24, 2003 and December 3, 2003, respectively. As discussed below, the Commission reverses the ALJs on the following issues: (1) the reconciliation period; (2) the length of time WTU must share off-system sales margins with its customers; (3) the inclusion of "negative margins" in computing energy-trading margins generated by the American Electric Power Company, Inc. (AEP) companies' trading activity; and (4) the inclusion of the value of "open transactions" in calculating those energy-trading margins. The fourth item was raised in motions for rehearing.

WTU's application, as modified by this Order on Rehearing, is approved.

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1. Effective December 23, 2002, the legal name of WTU changed to AEP Texas North Company.

## I. BACKGROUND

* * *

On March 22, 2004, the Office of Public Utility Counsel (OPC) and the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon (collectively Cities) filed motions for rehearing on the question of WTU's inclusion of the value of "open transactions" in calculating energy-trading margins. These parties contended that the ALJs erred in accepting WTU's calculation of those margins. Specifically, they claimed that WTU's affiliate American Electric Power Service Company (AEPSC) inappropriately included the "mark-to-market" (MTM) based value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. Consequently, they charged, the combined AEP East and West companies' base-year margins total was inflated; more importantly, the allocated share of the aggregated AEP reconciliation-period margins going to the AEP West companies (including WTU) was understated, causing WTU's customers to receive insufficient credit for those margins.[2]

WTU disputed OPC's and Cities' claim, arguing that the inclusion of MTM-valued open transactions in calculating the AEP East companies' margins was entirely appropriate.[3]

At its May 13, 2004 open meeting, the Commission granted the intervening parties' motion for rehearing. As discussed in section II.C. below, the Commission found that

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2. *See* Motions for Rehearing of OPC and Cities (Mar. 22, 2004).

3. *See* WTU's Reply to Motions for Rehearing (Mar. 31, 2004).

AEPSC inappropriately included the MTM-based value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year. Consequently, the combined AEP East and West companies' base-year margins total was inflated by approximately $84.2 million. In addition, the share of the aggregated AEP reconciliation-period margins going to the AEP West companies was understated, and WTU's customers received insufficient credit for those margins.[4]

The Commission also found, however, that the record contained insufficient evidence on the dollar impact of the above ruling on WTU's final fuel-expense balance. Therefore, the Commission again remanded this docket to SOAH to determine that impact.[5]

Following this second remand, all parties in this case reached agreement on the dollar impact of the Commission's ruling regarding the open transactions. The Commission adopts the parties' agreed-upon findings, as outlined in the discussion section below.

## II. Discussion

* * *

### D. Including the Value of Open Transactions in Energy-Trading Margins

Pursuant to the SIA, the AEP companies' energy trading and marketing margins are allocated between the AEP West and AEP East operating companies in two tiers. The first tier is based on a ratio of pre-merger CSW margins to pre-merger AEP East margins in the base year, *i.e.*, July 1999 through June 2000. Transactions are allocated based on

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4. *See* Second Order on Remand (May 20, 2004).

5. *Id.*

that ratio until the base-year level of margins is reached. After the base-year level of margins is reached, additional margins are shared according to the ratio of owned generating capacity.

AEPSC reported that the base-year (and hence first-tier) margin allocator for the AEP East companies was 91%, whereas the allocator for the AEP West (formerly CSW) companies was 9%. OPC and Cities objected that this allocation underestimated the correct base-year allocator for the AEP West companies by inappropriately including $84.2 million for the estimated value of "open transactions"[6] at the end of the base year.[7]

To value the unrealized gain or loss of an open transaction over the term of such a contract, AEPSC used MTM accounting. Stating that "[o]ther parties assailed these methods in argument, but provided no actual evidence to rebut WTU's position,"[8] the ALJs in this case accepted AEPSC's inclusion of MTM-valued open transactions in calculating base-year margins for the AEP East companies.

The Commission disagrees with the apparent view of the ALJs that the inclusion of the MTM-valued open transactions is an accounting issue. Section 1.9 of the SIA defines the "Base Year Allocation" as the "relative percentages of the total Trading and Marketing *realization* from Off-System Sales . . . *received* by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand" during the 12 months preceding the effective date of the merger. (Emphasis

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6. *See* PFD at 46.

7. *See* Supplemental Direct Testimony of Scott Norwood, OPC Ex. 22 at 26 (Oct. 29, 2002).

8. PFD at 64.

added.) "Trading and Marketing Realization" is defined in Section 1.39 of the SIA as "the difference between (i) *revenues collected* from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities." (Emphasis added.) This language from the SIA clearly indicates that it is actual revenues and expenses from settled transactions (either from physical delivery or bookouts) that are to be included in the base-year margin calculation, not the value of open positions. The SIA says nothing about the use of MTM accounting to value open transactions. The MTM values did not represent revenues collected, but were just interim estimates of the value of the AEP East open transactions at the end of the base year. Accordingly, the Commission reverses the findings of the ALJs in this case regarding the inclusion of MTM-valued open transactions in the AEP East margin calculation.

Excluding the $84.2 million from the AEP East base-year margins total affects the sharing of margins in two respects. First, the exclusion decreases the AEP East first-tier share to 87% and increases the AEP West first-tier share to 13%; second, the exclusion lowers the base-year level of total AEP margins, so that the $84.2 million is allocated on the second-tier basis of owned generating capacity.[9] Because the AEP West companies' 40% share of generating capacity greatly exceeds their 13% first-tier share, the increase in the level of post-base-year trading margins subject to the generating-capacity allocator increases the energy-trading revenues allocated to WTU and the other AEP West companies.[10]

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9. *See* Norwood Supplemental Direct, OPC Ex. 22 at 27.

10. *Id.*

Under the parties' stipulation after the second remand, the effect of removing the MTM-based value of open transactions is an increase of $3,235,526 in the margins passed through to WTU's Texas retail customers during the 18-month reconciliation period (July 2000-December 2001). With this adjustment, the share of the reconciliation-period margins going to Texas retail customers rises to $5,774,177.

Consistent with the Commission's decision (discussed in section II.B.) to require WTU to continue sharing margins for the 42 months beyond 2001, the parties also calculated the increase in margins flowing through to WTU's Texas retail customers during the post-reconciliation period. This effect is an increase of $4,638,254 going to those customers. With this increase, the total share of the AEP Companies' post-reconciliation margins going to WTU's Texas retail customers is $14,091,805.

Combining the customers' share of margins during the reconciliation and post-reconciliation periods yields a total of $19,865,982, which is an increase of $7,873,780 resulting from the removal of the open transactions from the margin-sharing.

* * *

***Second Remand Proceeding***

84. At the May 13, 2004 open meeting, the Commission granted intervenors' motions for rehearing on the issue of inclusion of the mark-to-market (MTM) value of open transactions in calculating base-year trading margins and remanded that issue back to SOAH for further evidence to establish the dollar impact on off-system sales margins of excluding the value of open transactions. [Stipulated finding of fact 1.]

85. On May 20, 2004, the Commission issued its Second Order on Remand, finding it inappropriate to include

the MTM value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. [Stipulated finding of fact 2.]

86. On June 8, 2004, the ALJ issued Order No. 20, adopting a procedural schedule. [Stipulated finding of fact 3.]

87. On July 24, 2004, WTU filed a status report indicating that the parties reached an agreement and jointly filed an agreed-upon Stipulation of Fact. WTU also filed a motion to abate the procedural schedule and a request to return the proceeding to the Commission for issuance of a final order. [Stipulated finding of fact 4.]

88. On July 6, 2004, the ALJ issued Order No. 21, admitting the Stipulation of Fact into the record and returning the case to the Commission for disposition. Order No. 21 also required the parties to file joint proposed findings of fact and conclusions of law. [Stipulated finding of fact 5.]

***Mark-to-Market Accounting***

89. Under Service Schedule D of the SIA, Trading and Marketing Realizations are to be allocated on an hourly basis between AEP East and AEP West companies in accordance with the Base Year Allocation up to the level of realizations achieved in the Base Year, and for any realization achieved in excess of the base-year amount, allocated according to the ratio of owned generating capacity.

90. *Trading and Marketing Realizations* is defined in the SIA as "the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Costs of such Trading and Marketing

Activities and any transmission cost related to such activities.

91. *Base Year Allocation* is defined in the SIA as the "relative percentages of the total Trading and Marketing realization from Off-System Sales (other than Off-System Sales having a term of one-year or longer entered into prior to the Merger) received by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand, during the last full twelve (12) calendar month period prior to the Effective Time as defined in the Agreement and Plan of Merger (the "Base Year").

92. Mark-to-market valuation of an open position is an estimated value of the contract and is not an amount of revenues collected under such contract. Valuing an open position does not result in AEP receiving revenues.

93. The value assigned to an open position is not determinative of the amount of revenue, if any, that would be received when that position is closed out during a later accounting period.

94. The effect of removing the mark-to-market value of open transactions from the base-year allocation is an increase of $3,235,526 in the margins passed through to WTU's retail customers during the reconciliation period. With this adjustment, the Texas retail customers' share of margins for the reconciliation period is $5,774,177. (See Joint Exhibit No. 1.) [Stipulated finding of fact 6.]

95. The Commission determined that WTU has an obligation to share margins generated after the close of the reconciliation period. The Commission also indicated that it would adopt Scott Norwood's method

of estimating post-reconciliation margins. The effect of removal of the MTM value of open transactions from the base-year allocation results in an increase of $4,638,254 in the margins passed through to WTU retail customers in the 42 months after the close of the reconciliation period. With this adjustment, the Texas retail customers' share of the post-reconciliation period margins would be $14,091,805. (See Joint Exhibit No. 1.) [Stipulated finding of fact 7.]

## IV. Conclusions of Law

* * *

24A. The Commission found that it is inappropriate to include the mark-to-market (MTM) value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. [Stipulated conclusion of law 1.]

24B. The amounts referred to in finding of facts. 94 and 95 accurately reflect the effect of the Commission's ruling concerning the impact of removing the MTM value of open transactions. [Stipulated conclusion of law 2.]

* * *

SIGNED AT AUSTIN, TEXAS the 18th day of October 2004.

PUBLIC UTILITY COMMISSION OF TEXAS

JULIE PARSLEY, COMMISSIONER

PAUL HUDSON, CHAIRMAN

BARRY T. SMITHERMAN, COMMISSIONER